

DEPARTMENT OF STATE REVENUE

LETTER OF FINDINGS NUMBER 2004-0302P

**ADJUSTED GROSS INCOME TAX FOR
THE PERIOD COVERING THE FISCAL YEARS ENDING
SEPTEMBER 26, 2000, SEPTEMBER 29, 2001 AND SEPTEMBER 28, 2002**

NOTICE: Under IC § 4-22-7-7, this document is required to be published in the *Indiana Register* and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the *Indiana Register*. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUE

I. Tax Administration—Negligence Penalty

Authority: IC §§ 6-8.1-5-1(b), -10-2.1 (1998); 45 IAC § 15-11-2 (1996) (2001)

STATEMENT OF FACTS

The Department conducted an income tax audit of the taxpayer for its fiscal years ending September 26, 2000, September 29, 2001 and September 28, 2002 (hereinafter “the audit period”). During the audit period the taxpayer was a corporation with its commercial domicile outside Indiana and engaged in the retail sporting goods trade. A holding company had acquired the taxpayer in 1998, but it kept filing Indiana Corporate Income Tax Returns (Forms IT-20) during the audit period. The taxpayer’s business was unitary, with the taxpayer operating one retail outlet in Indiana during the audit period. None of the taxpayer’s affiliate companies did business in Indiana during that time.

The auditor made adjustments to, and the Department’s Audit Division issued Notices of Proposed Assessment of, the taxpayer’s adjusted gross income tax (hereinafter “AGIT”) liability for the fiscal years ending September 26, 2000 and September 28, 2002 (hereinafter “fiscal year 2000” and “fiscal year 2002,” respectively). The audit changes arose from computational errors the taxpayer made in preparing its returns for fiscal years 2000 and 2002. Specifically, in computing Indiana adjusted gross income (hereinafter “AGI”) for fiscal year 2000 the taxpayer erroneously added back the loss it had sustained on depreciable assets. IC § 6-3-1-3.5(b) (1998) and its implementing regulation, 45 IAC § 3.1-1-8, which set out the corporate AGI formula, did not and at this writing still do not permit taxpayers to add back such losses.

In addition, in both fiscal years 2000 and 2002 the taxpayer also had carried forward and deducted Indiana net operating losses (hereinafter “NOLs”) it had incurred for short tax years

ending January 9, 1998 and September 30, 1998. In calculating those NOLs the taxpayer failed to include adjustments for the state income and property taxes it had deducted on its federal income tax returns for the 1998 short years, as IC § 6-3-1-3.5 (1998) then required. (The adjustment for property taxes was later deleted from IC § 6-3-1-3.5 for reporting periods ending after December 31, 1998.) The auditor recalculated the NOLs for those periods and adjusted its Indiana NOL deductions for fiscal years 2000 and 2002 accordingly. The adjustments' effect was overwhelmingly on fiscal year 2002, but the adjustments did affect both fiscal years.

In addition to AGIT and interest, the Notices of Proposed Assessment also included 10% negligence penalties. The taxpayer paid the principal taxes assessed plus interest accrued to the date of payment, and filed a timely protest of the penalties. The employee of the taxpayer having responsibility for this matter called the Department's hearings officer on September 3, 2004, in response to an initial contact letter dated August 26, 2004 the hearings officer had sent. That letter indicated that the taxpayer could submit any additional evidence it might have, with or without a hearing. In that conversation the employee indicated that the taxpayer had no additional evidence to submit, nor did she request a hearing on the taxpayer's behalf. Accordingly, the Department finds the record of this protest to be complete and closed, and the protest ripe for decision.

DISCUSSION

A. TAXPAYER'S ARGUMENT

The taxpayer makes general allegations in support of its protest that the Department should abate the penalty because it tries to follow the tax laws and regulations that the Department administers, and that the taxpayer has always filed its returns on time.

B. ANALYSIS

IC § 6-8.1-10-2.1(a)(1), (a)(3), (d) and (f) (1998) respectively read as follows:

(a) If a person:

(1) Fails to file a return for any of the listed taxes;

...

(3) Incurs, upon examination by the department, a deficiency that is due to *negligence*;

the person is subject to a penalty.

(d) If a person subject to the penalty imposed under this section can show that the failure to file a return, pay the full amount of tax shown on the person's return, timely remit tax held in trust, or pay the deficiency determined by the department was due to *reasonable cause* and not due to willful neglect, the department shall waive the penalty.

...

(f) The department shall adopt rules under IC 4-22-2 [i.e., the Indiana Administrative Orders and Procedures Act] to prescribe the circumstances that constitute *reasonable cause* and *negligence* for purposes of this section.

Id (emphases added). Title 45 IAC § 15-11-2(b) (1996⁶⁸) (2001) defines “negligence.” It states:

(b) “Negligence” on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's *carelessness*, thoughtlessness, disregard or *inattention to duties placed upon the taxpayer by the Indiana Code or department regulations*. *Ignorance of the listed tax laws, rules and/or regulations is treated as negligence*. *Further, failure to read and follow instructions provided by the department is treated as negligence*. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.

Id (emphases added).

The computational errors the taxpayer made appear to be the quintessence of “negligence” as the regulation defines it. Those mistakes indicate one of several possibilities. Either the taxpayer did not know the statutory and regulatory formulae it was applying, did not read (or did not follow, if it did read) the relevant instructions accompanying the Forms IT-20 for fiscal years 2000 and 2002, or was careless in applying the formulae. All of these circumstances are “negligence” as 45 IAC § 15-11-2(b) defines that word.

The taxpayer's generalized allegations of good faith efforts at compliance are not “reasonable cause” for abating negligence penalties. IC § 6-8.1-5-1(b) (1998) states in relevant part that “[t]he burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made.” *Id*. That burden applies to abatement of penalty, as well as substantive tax, assessments. “A person who wishes to avoid the penalty imposed under [IC § 6-8.1-10-2.1(a) and (b) (1998)] must make an affirmative showing of all *facts* alleged as a reasonable cause for the person's failure to file the return, pay the amount of tax shown on the person's return, pay the deficiency, or timely remit tax held in trust[.]” IC § 6-8.1-10-2.1(e) (emphasis added). *See also* 45 IAC § 15-11-2(c) (2001) requiring a taxpayer to “affirmatively

establish[,]” *id.*, specifying the standard for the existence of, and enumerating the factors that may be considered in determining the presence or absence of, reasonable cause). The taxpayer has made no factual showing of any kind, let alone one that would constitute “reasonable cause.”

The taxpayer’s further allegation that it has filed all its Indiana tax returns on time is irrelevant. IC § 6-8.1-10-2.1(a) (1998) sets out the circumstances under which a person is subject to a penalty. As quoted above, paragraphs (1) and (3) of this subsection draw a clear distinction between failing to file a return and incurring a deficiency upon examination that is due to negligence, respectively. The penalties the Department has proposed to assess against the taxpayer are of the latter, not the former, type. Thus, any allegation or evidence of timely filing of returns would have no tendency to prove or disprove that the calculations it made in preparing those returns was negligent.

FINDING

The taxpayer’s protest is denied.

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